

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 06-0337

**Use Tax
For Tax Year 2004**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Use Tax—Construction Services

Authority: IC § 6-2.5-1-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-1-1; 45 IAC 2.2-4-22

Taxpayer protests the assessment of sales tax on a unitary transaction.

II. Tax Administration—Negligence Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business. The Indiana Department of Revenue ("Department") conducted an audit for the tax years 2003 through 2005. As a result of the audit, the Department issued proposed assessments for sales and use tax for the years in question. Taxpayer protests the imposition of tax on a portion of a transaction in 2004. Further facts will be supplied as required.

I. Use Tax—Construction Services

DISCUSSION

Taxpayer protests the imposition of use tax on a portion of one transaction in 2004. The Department imposed use tax on the amount Taxpayer paid a contractor for the construction of a building on Taxpayer's property. At the time of construction, Taxpayer presented an exemption certificate to the contractor. The contractor did not pay sales tax on the materials it purchased for conversion to real property. The contractor billed

Taxpayer in a lump sum for the construction of the building. The contractor did not charge sales tax on the lump sum, since it had received an exemption certificate for materials, and services alone are not subject to sales tax. In the audit, the Department determined that sales tax should have been paid on the construction materials for the building. The Department also determined, since the contractor charged Taxpayer in a lump sum for the entire cost of constructing the building, that use tax should apply to the entire amount. Taxpayer protests that use tax should only apply to the cost of materials incorporated into the building, and not to the cost of labor. The Department refers to IC § 6-8.1-5-1(b), which explains that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made.

In the audit report, the Department refers to 45 IAC 2.2-4-22(e), which states:

Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

- (1) He converts the construction material into realty on land he owns and then sells the improved real estate;
- (2) He utilizes the construction material for his own benefit; or
- (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

A disposition under C. *[subsection (e)(3) of this section]* will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchaser (purchaser) or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

Taxpayer protests that it should not now be required to pay use tax on the entire amount the contractor charged for construction of the building. Taxpayer refers to IC § 6-2.5-3-2(c), which states:

The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located. However, the use tax does not apply to additions of tangible personal property described in this subsection, if:

- (1) the state gross retail or use tax has been previously imposed on the sale or use of that property; or
- (2) the ultimate purchaser or recipient of that property would have been exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

Taxpayer believes that under IC § 6-2.5-3-2(c), the Department should only seek to collect use tax on the amount of materials used in the construction, since the labor would not be subject to sales tax.

The Department refers to IC § 6-2.5-1-1, which states:

(a) Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

(b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.

Next, 45 IAC 2.2-1-1(a) states:

Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

The documentation available shows that the contractor charged a single amount for both labor and materials for construction of the building. Under 45 IAC 2.2-1-1(a), use tax applies to all items of property and services for which a total combined charge or selling price is computed, regardless of the fact that services which would not otherwise be taxable are included in the selling price. Therefore, the Department was correct to impose use tax on the amount the contractor charged Taxpayer for construction of the building.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has not affirmatively established that his failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

WL/BK/DK May 7, 2007